

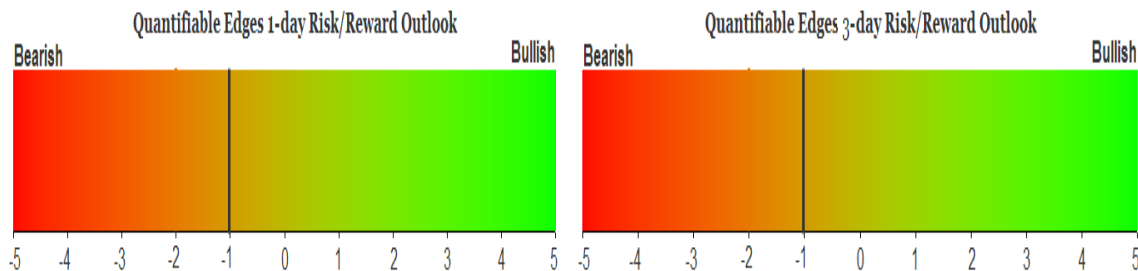
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 20, 2013

Volume 6 Issue 96

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- SPY hitting 10-day highs after closing > 5ma for at least 10 straight days suggests extended condition likely to pull back.
- When opex week closes up 1%-2%, it is often followed by a short-term pullback.
- A 50-day high, an inside day, and then another 50-day high have often been followed by a pullback.

Short-term Outlook

The Bottom Line

The market is squarely overbought but evidence is fairly neutral. I am not inclined to fight strong liquidity and a strong uptrend to try and take advantage of a marginal downside edge. It is still a waiting game for me.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 18, 2013	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%
May 18, 2013	50-high. Inside day. 50-high.	1 day	Bearish	
May 18, 2013	SPY > 5ma for 10 days. 10-high	1-2 days	Bearish	
May 17, 2013	Big drop from 50-high	1-4 days	Bullish	1.20%
May 16, 2013	VIX up. SPX 50-high. Twice.	1-3 days	Bearish	
Active - Long Term				
May 10, 2013	5 days up to 50-high, then 1 down	1-10 days	Bullish	2.00%
May 9, 2013	Breadth Confirms Rally (Study of Tops)	int term	Bullish	
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	Sell in May unless Jan-April strong	1-6 months	Bullish	6.80%
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
May 16, 2013	8-day avg closing range > 75%	1-2 days	Bearish	
April 26, 2013	5 higher highs < 50-high.	1-15 days	Bullish	2.80%
April 24, 2013	SPX up 2% in 3 days. 3/10OffHV < 0.	1-19 days	Bullish	4.50%

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

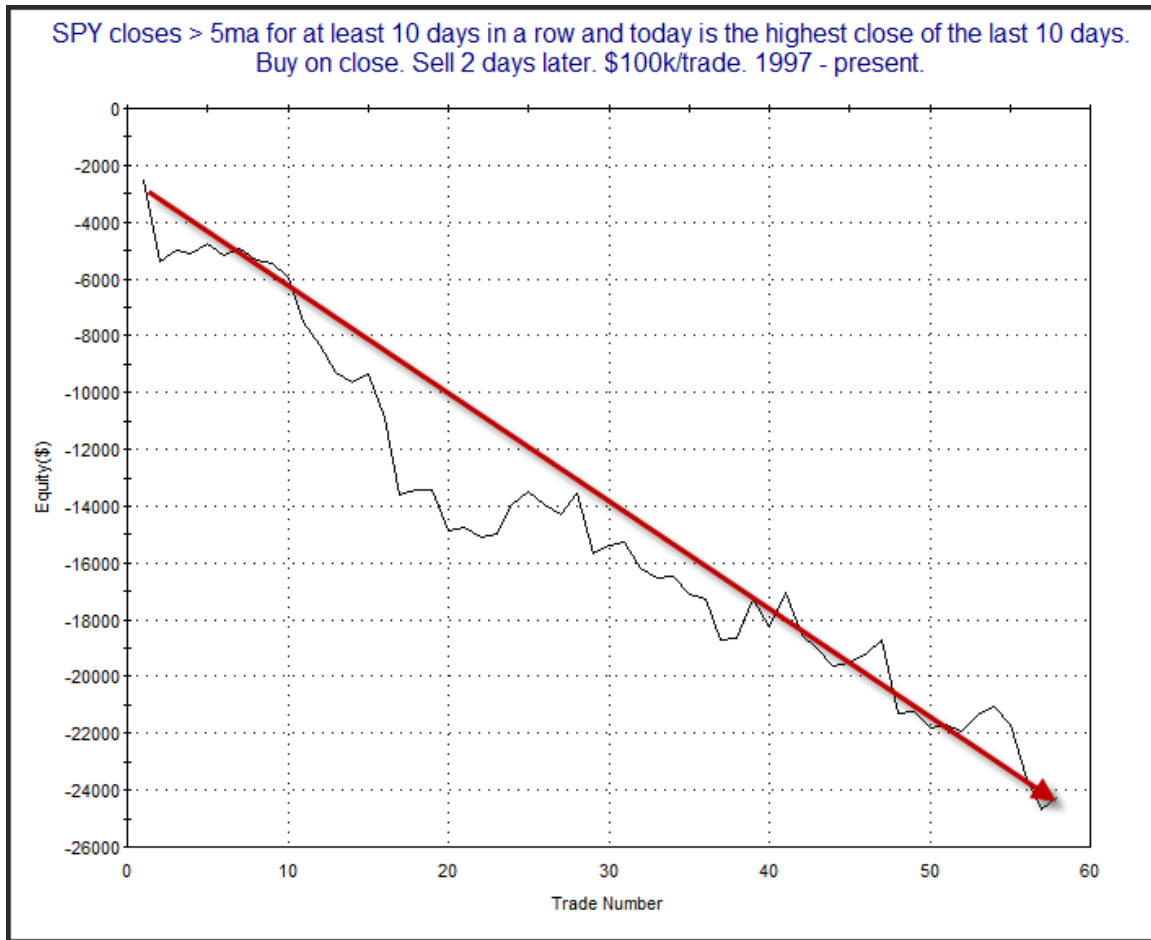
The Evidence

Friday was another strong day for the market as the major averages all posted nice gains. The SPX and Nasdaq both closed up 1.0%, while the Russell 2000 gained 1.1%. Breadth was strongly positive as the NYSE Up Issues % was 72% and the Up Volume % came in at 81%. Total NYSE volume was high, largely thanks to options expiration.

SPY is now up to 12 days without closing below its 5ma. That's an unusually long period of time to hold above such a short-term moving average. The study below was last seen just a couple of days ago in the 3/15/13 subscriber letter. It looked at other instances in which the market had traded above the 5ma for at least 2 weeks and was now closing at a 10-day high. All results are updated.

SPY closes > 5ma for at least 10 days in a row and today is the highest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1997 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-14,437.32	40	21	19	52.50	738.86	2,516.52	-1,576.49	-4,014.40	0.47	0.52	-360.93
4	-19,906.83	43	17	26	39.53	657.75	1,428.90	-1,195.72	-3,723.20	0.55	0.36	-462.95
3	-21,116.10	50	17	33	34.00	610.90	1,294.25	-954.59	-3,235.65	0.64	0.33	-422.32
2	-24,199.21	58	24	33	41.38	393.41	1,392.65	-1,019.43	-2,870.40	0.39	0.28	-417.23
1	-23,681.26	81	32	49	39.51	292.19	1,134.24	-674.11	-2,817.32	0.43	0.28	-292.36
89% of instances closed below the entry price at some point in the next week.												

In the past this setup has almost always been followed by a short-term pullback. The downside edge doesn't last long, though. It seems to pretty much play itself out over the first 2 days. Below is an equity curve showing how the edge has evolved over time. It uses a 2-day exit strategy.

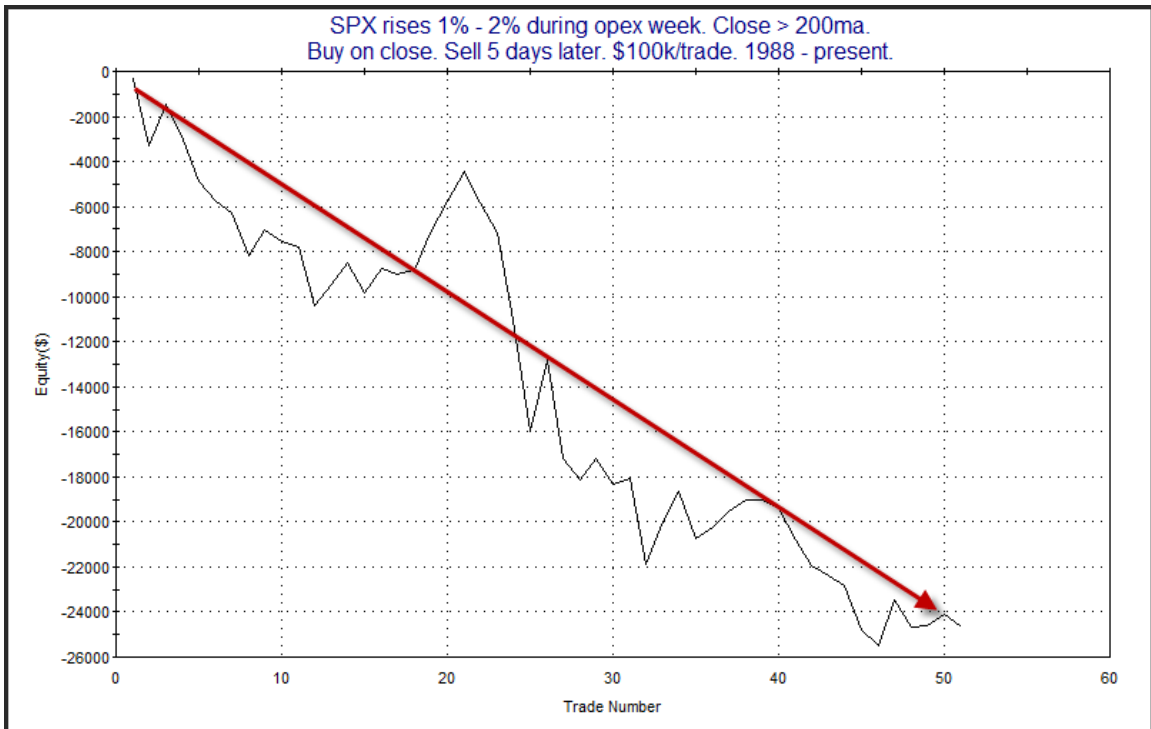


The strong steady downslope seems to confirm the bearish edge.

Strong moves opex week will often be followed by a pullback the following week. This is something we saw in the 6/18/12 subscriber letter. I have updated the study from that letter below.

SPX rises 1% - 2% during opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-24,699.31	51	20	31	39.22	1,121.38	3,146.64	-1,520.22	-4,961.56	0.74	0.48	-484.30
4	-19,586.06	51	18	33	35.29	984.28	3,212.16	-1,130.40	-4,046.70	0.87	0.47	-384.04
3	-4,995.19	51	26	25	50.98	788.52	3,403.68	-1,019.87	-2,765.00	0.77	0.80	-97.94
2	-7,524.17	51	25	26	49.02	596.48	1,590.30	-862.93	-2,917.60	0.69	0.66	-147.53
1	-4,136.12	51	21	30	41.18	526.21	1,739.10	-506.22	-2,470.65	1.04	0.73	-81.10

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



There was definitely a bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

After Wednesday's move to a new high, Thursday put in an inside day. With Friday closing at another new high the study below triggered. It was last seen in the 2/8/12 subscriber letter. I have updated all statistics.

After closing at a 50-day high 2 days ago, SPY posts an inside day yesterday and then closes at a new high again today. Buy on close. Sell X days later. \$100k/trade. 1999 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-15,684.45	15	4	11	26.67	543.40	1,176.56	-1,623.46	-3,754.10	0.33	0.12	-1,045.63
4	-10,810.77	15	5	10	33.33	668.94	1,138.36	-1,415.55	-5,106.46	0.47	0.24	-720.72
3	-10,014.58	15	6	9	40.00	472.81	1,367.56	-1,427.94	-3,417.34	0.33	0.22	-667.64
2	-9,745.08	15	3	12	20.00	747.64	911.40	-999.00	-2,737.00	0.75	0.19	-649.67
1	-5,119.95	15	2	13	13.33	289.54	296.40	-438.39	-1,405.62	0.66	0.10	-341.33

Only 1 instance failed to close below the entry price at some point in the next 5 days. It triggered on 2/3/11.

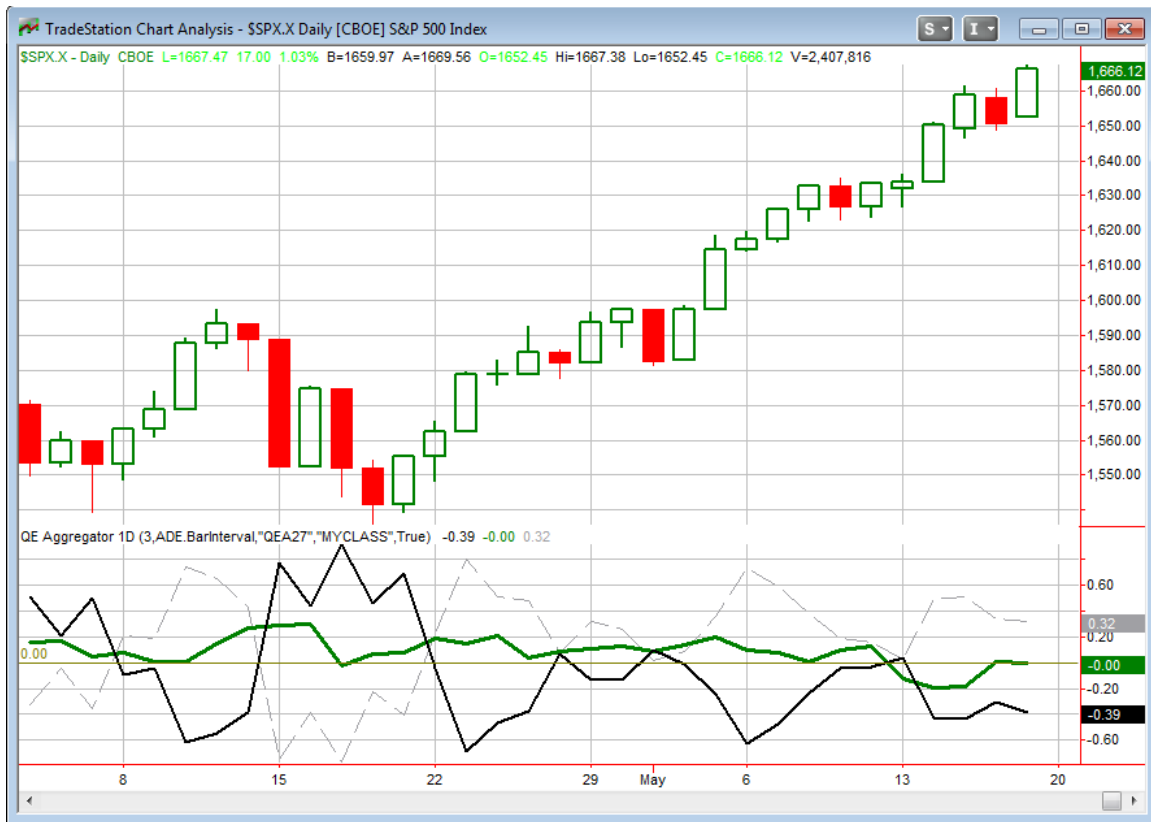
Stats here suggest a bearish inclination following action similar to the last 3 days. One day later the market has declined 13 of 15 times. Below I have listed all 15 instances.

After closing at a 50-day high 2 days ago, SPY posts an inside day yesterday and then closes at a new high again today.
Buy on close. Sell X days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/08/99	Buy	\$127.75	(0.95%)	\$0.00
01/11/99	Sell	\$126.53		(\$1,978.46)
03/15/99	Buy	\$131.22	(0.38%)	\$335.28
03/16/99	Sell	\$130.72		(\$571.50)
11/18/99	Buy	\$142.63	(0.09%)	\$238.34
11/19/99	Sell	\$142.50		(\$441.63)
08/28/00	Buy	\$151.77	(0.12%)	\$72.38
08/29/00	Sell	\$151.59		(\$565.88)
06/22/05	Buy	\$121.57	(1.41%)	\$24.66
06/23/05	Sell	\$119.86		(\$1,430.28)
07/14/05	Buy	\$122.91	(0.06%)	\$105.69
07/15/05	Sell	\$122.84		(\$447.15)
07/22/05	Buy	\$123.54	(0.28%)	\$331.69
07/25/05	Sell	\$123.19		(\$558.21)
05/09/06	Buy	\$132.62	(0.05%)	\$98.02
05/10/06	Sell	\$132.55		(\$550.42)
11/22/06	Buy	\$140.92	(0.40%)	\$0.00
11/24/06	Sell	\$140.35		(\$510.48)
10/09/07	Buy	\$156.48	(0.17%)	\$0.00
10/10/07	Sell	\$156.22		(\$683.73)
05/06/09	Buy	\$92.14	(1.39%)	\$1,095.85
05/07/09	Sell	\$90.86		(\$2,018.10)
08/04/10	Buy	\$112.97	(0.11%)	\$0.00
08/05/10	Sell	\$112.85		(\$787.65)
02/03/11	Buy	\$130.78	0.28%	\$320.88
02/04/11	Sell	\$131.15		(\$420.20)
02/07/12	Buy	\$134.79	0.30%	\$318.63
02/08/12	Sell	\$135.19		(\$355.68)
03/19/12	Buy	\$140.85	(0.29%)	\$0.00
03/20/12	Sell	\$140.44		(\$857.89)
Avg Run-up: 0.2%				Avg Drawdown: -0.8%

Risk/reward here heavily favors the short side. The average drawdown is slightly over 4 times the size the average run-up. Also notable is that every instance saw drawdown of at least 0.35% the next day, but only 1 of the 15 instances saw run-up of at least 0.35%. With all this in mind I believe this study worthy of inclusion on the Active Studies List.

I have updated the [Aggregator](#) chart below.



Tonight's studies helped turn the green Aggregator Line back to just barely below zero. It has been close to breakeven the last 2 days. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line remained well below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is still overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator system to turn short at the close.

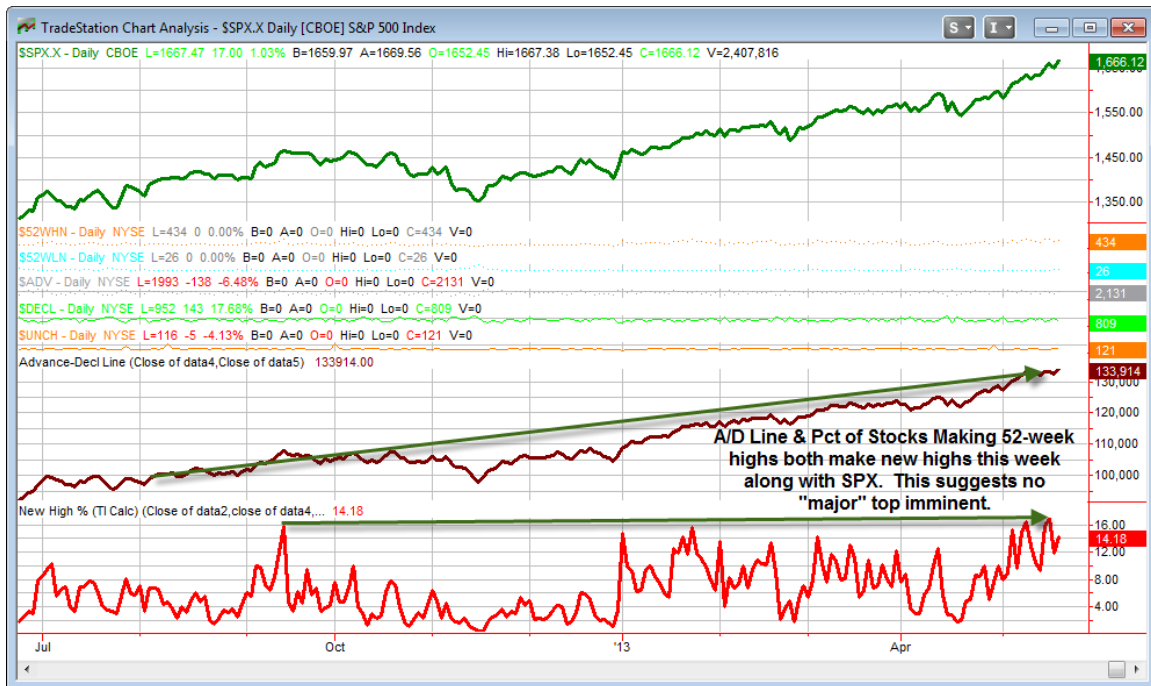
Based on the current studies, expectations are slated to remain negative on Monday. Of course this could change if new bullish evidence emerges. The Differential Pivot will be 1,650.11 on Monday. This is about 1.0% below Friday's close. So SPX will need to close down at least this much in order for it to move from overbought to oversold versus expectations.

There appears to be a mild downside edge, but trend & liquidity are too strong for me to want to exploit it. I have not been inclined to take any shorts since the QE Buying Power Index got locked at 5 at the beginning of the year, and I don't see compelling enough evidence to get me to start trying to short now. So I remain mostly sidelined and awaiting the next strongly favorable setup.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/20 –bullish

The market put in another strong week, and is *again* at new highs, erasing any doubt of an uptrend. The persistent move higher has been impressive. And while no new intermediate-term studies emerged this week, the open ones continue to all favor a further rally.

One very positive sign was that a couple of breadth indicators we track again made new highs this week. Those were the NYSE Advance/Decline Line, and the percent of stocks hitting new 52-week highs. In the Quantifiable Edges Study of Tops (always available on the Downloads page for subscribers) I went through every major top since 1970. For purposes of that study I defined a “major top” as any top that was followed by a decline of at least 20%. I found that in every case, there was a divergence in % of NYSE issues hitting new 52 week highs, and that the divergence was in effect for at least 2 months before any market top. Here is an updated chart with that indicator.

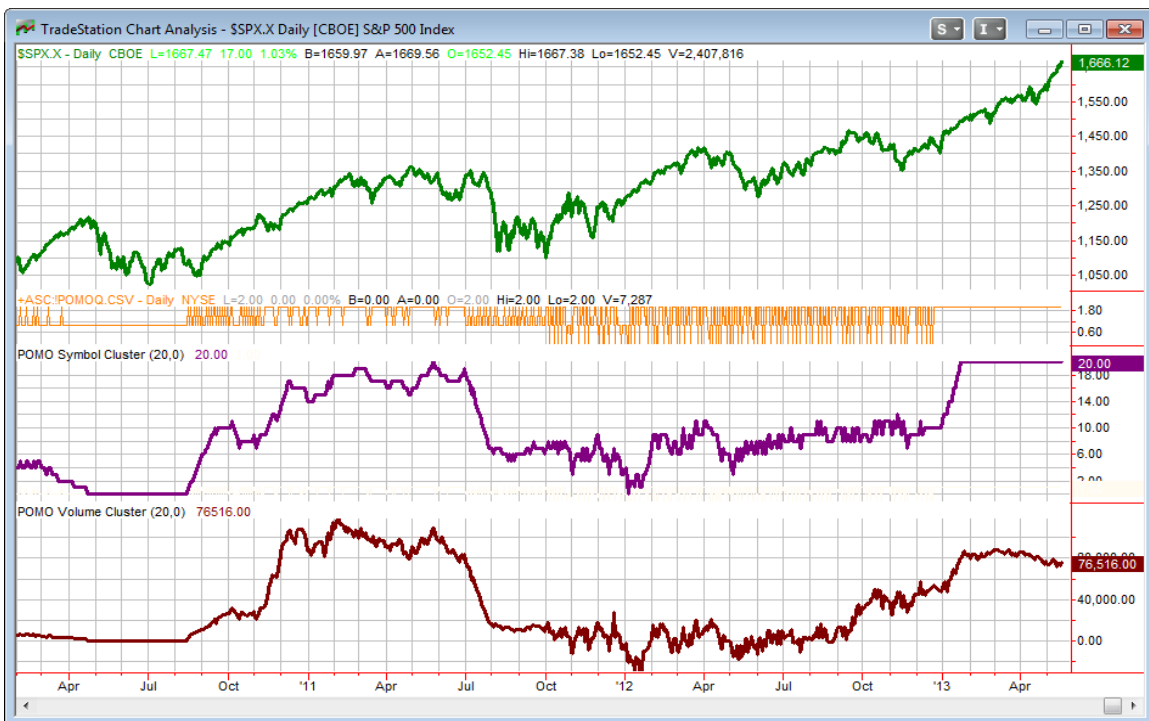


While the market is always capable of doing something new, Wednesday’s high readings appear to greatly reduce the risk of a bear market beginning in the next 2 months. For a view of all tops since 1970, please refer to the Study of Tops. Here is a link for your convenience.

[QEStudyOfTops.pdf](#)

I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A “POMO Day” is simply a day where these operations take place. The chart below shows a couple of indicators. The top pane is the S&P 500. The middle (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) the system over the previous 20 days. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed’s new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.



The POMO/AMBS volume indicator curled back up a little this week. The days indicator is *still* maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about \$20.2 billion, which is an impressive amount. In the past, inflows of this magnitude have typically been bullish looking out over the next several days.

This upcoming week we expect to see liquidity flows of about \$18.6 billion. While lower, this should continue to keep the liquidity environment positive.

Bullish studies continue to dominate the intermediate-term. The leading Nasdaq, the “6 up months” study and the “Sell in May unless there hasn’t been a 5% pullback” studies all listed among the Active Studies at the top of this letter all support the bullish case. And of course, the factor I consider to be most important is liquidity flows. The Fed pump is still on. And as long as the Fed is pumping strongly it does not seem advisable to bet against the market. So my intermediate-term outlook remains bullish again this week. From a trading standpoint that generally means I will be more aggressive from the long side, and very conservative about shorting.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

EXC- bought 1/3 @ \$35.25 limit

Catapult for ETF’s Trades

None

Broad Market Large Cap CBI – 1(EXC)

Additional New Trade Ideas

A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EXC(1/3)	5/7/2013	\$35.25	\$35.15	-0.28%		Catapult

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